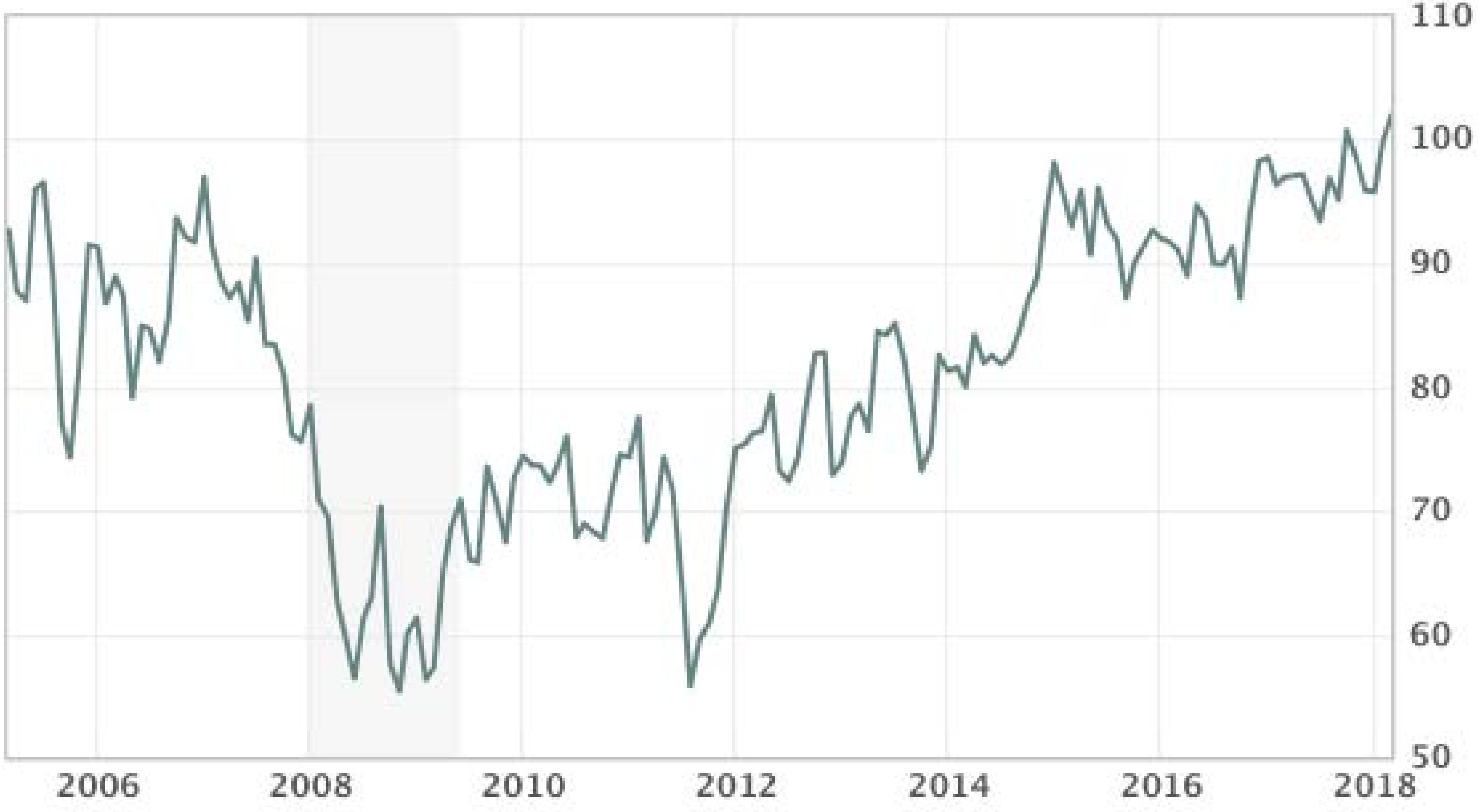
Trends and Disruptions in the Supermarket Industry

Chris Jones,
Vice President of Government Relations & Counsel

NATIONAL GROCERS ASSOCIATION

University of Michigan consumer sentiment

Index 1966:Q1=100, not seasonally adjusted



Source: University of Michigan via FRED

U.S. Unemployment Rate

Why Isn’t the Supermarket Sector Performing Better??

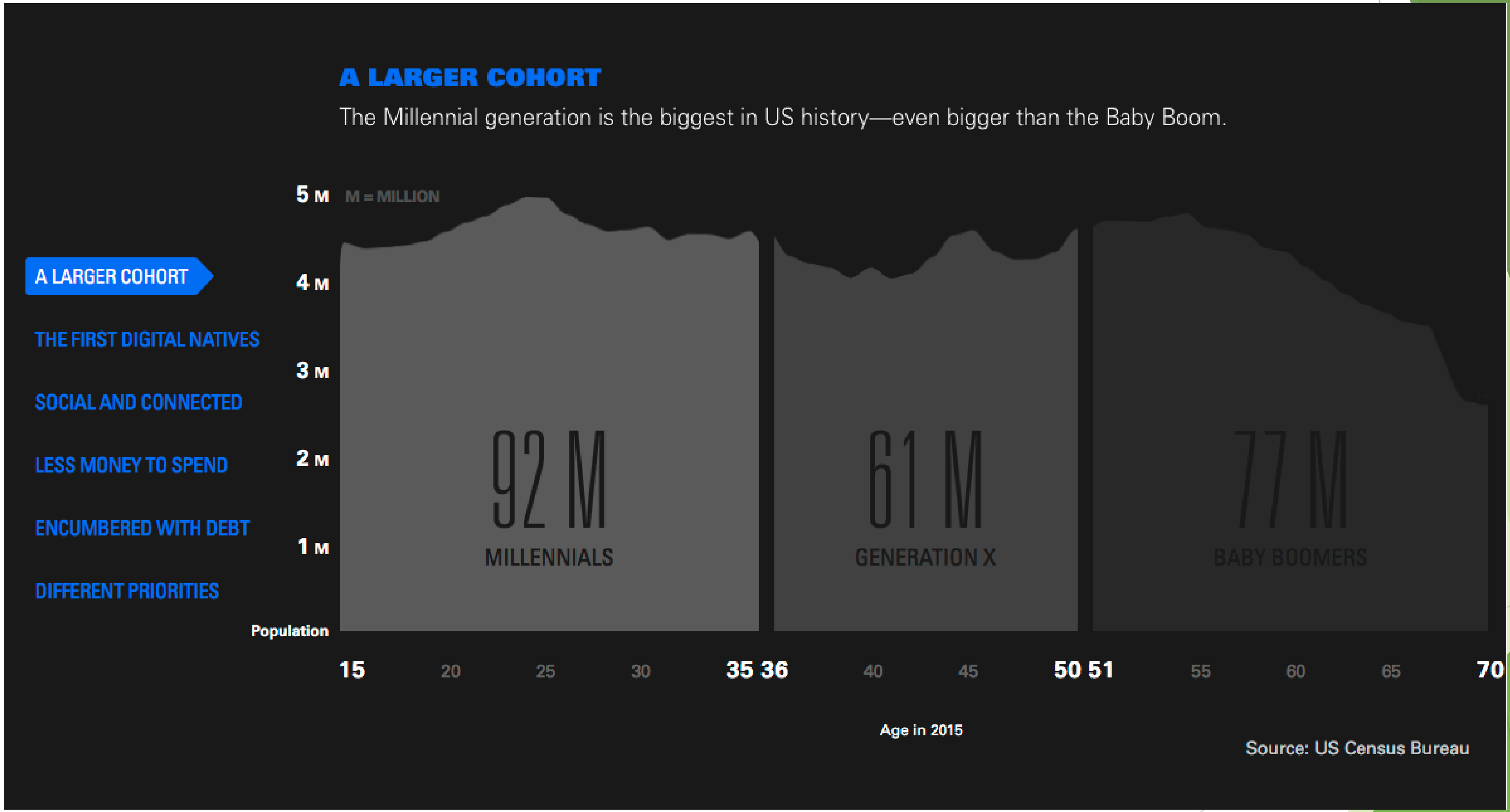
- Underlying trends in consumer demographics, attitudes and behaviors

- The digital transformation of society and retailing in particular

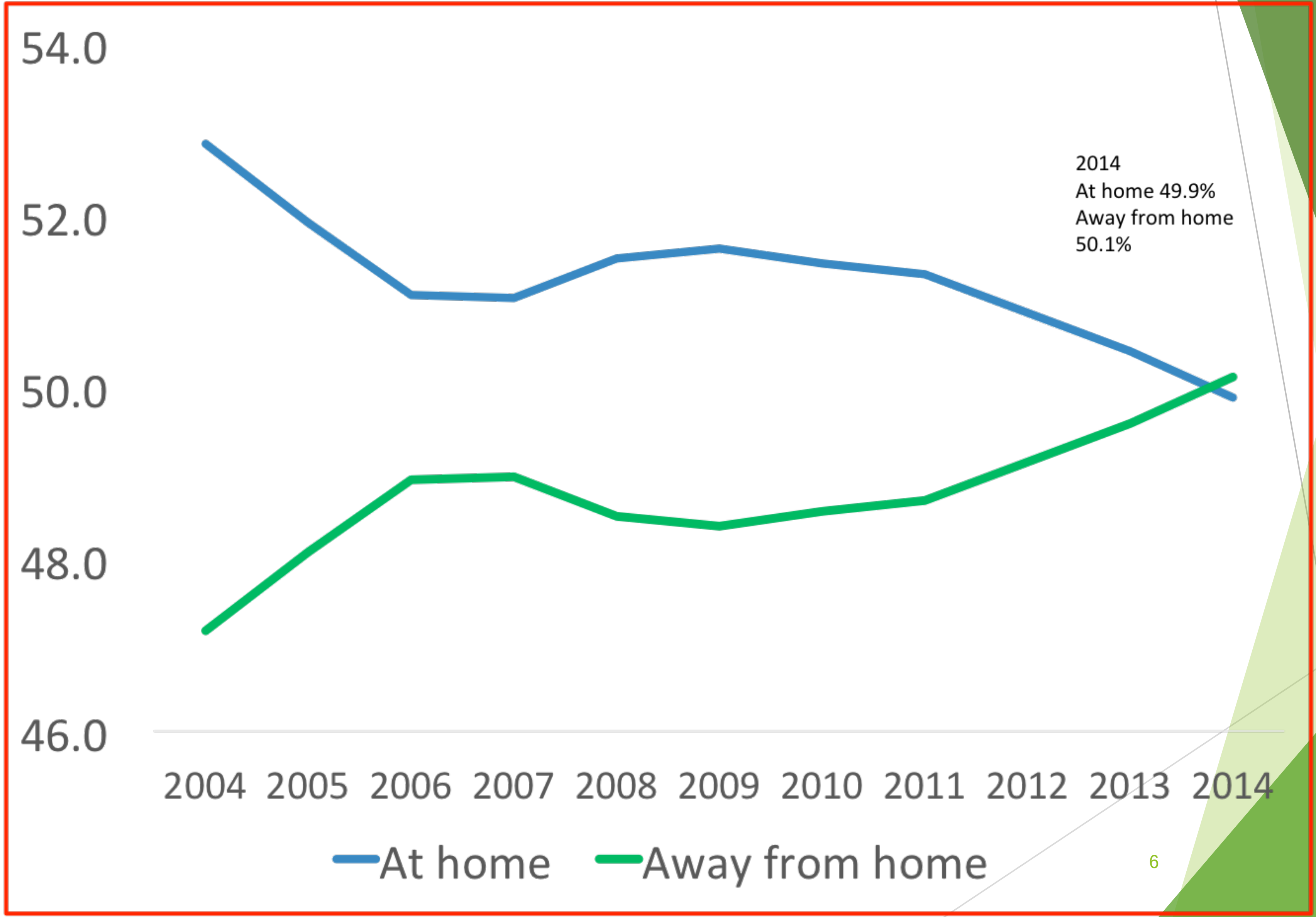
- Competitive conditions:
  - too much unproductive square footage
  - growth of non-traditional competitors
  - resurgence of Walmart

- Tight labor markets, wage escalation, rising health care costs

The Rise of the Millennials



Food Away From Home Expenditures Now Greater than 50%



Source: USDA-ERS, Food Expenditures data series

FOOD INDUSTRY ISSUES

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- Labor
- Natural Resources
- Environment
- Health
- Local
- Food Safety
- Human Rights
- GMOs
- Social Responsibility
- Food Waste
- Sustainability
- Hunger
- Food Security(D)
- Food Security(T)
- Food Deserts
- Animal Welfare
- Gluten Free
- Organic
- Fair Trade
- Natural
- Obesity

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HEART

Study Questions Fat and Heart Disease Link

By ANAHAD O'CONNOR MARCH 17, 2014 5:00 PM 482 Comments

For Teenagers, Potassium May Matter More Than Salt

By TARA PARKER-POPE APRIL 27, 2015 2:47 PM 29 Comments

iStock

Email

A diet high in potassium appears to protect teenagers from high blood pressure in adulthood, while a low-salt diet had no effect, according to new research.

Foods Loaded With Sugar, Salt and Fat? Bring It

By STEPHANIE STROM APRIL 22, 2016

The Full-Fat Paradox: Dairy Fat Linked To Lower Diabetes Risk

April 18, 2016 · 4:30 AM ET
Heard on Morning Edition

ALLISON AUBREY

- “Big” has become bad

- Traditional, large food
- companies losing share

- Consumers want less – simplicity, fewer ingredients and less processing – a new definition of healthiness

- Can large, established food companies provide “authentic and genuine” food experiences?

Size:	40g
Calories:	200
Fat Calories:	140
Total Fat:	15g

Size:	44g
Calories:	215
Fat Calories:	100
Total Fat:	11g

Size:	40g
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Calories:	215
Fat Calories:	100
Total Fat:	11g

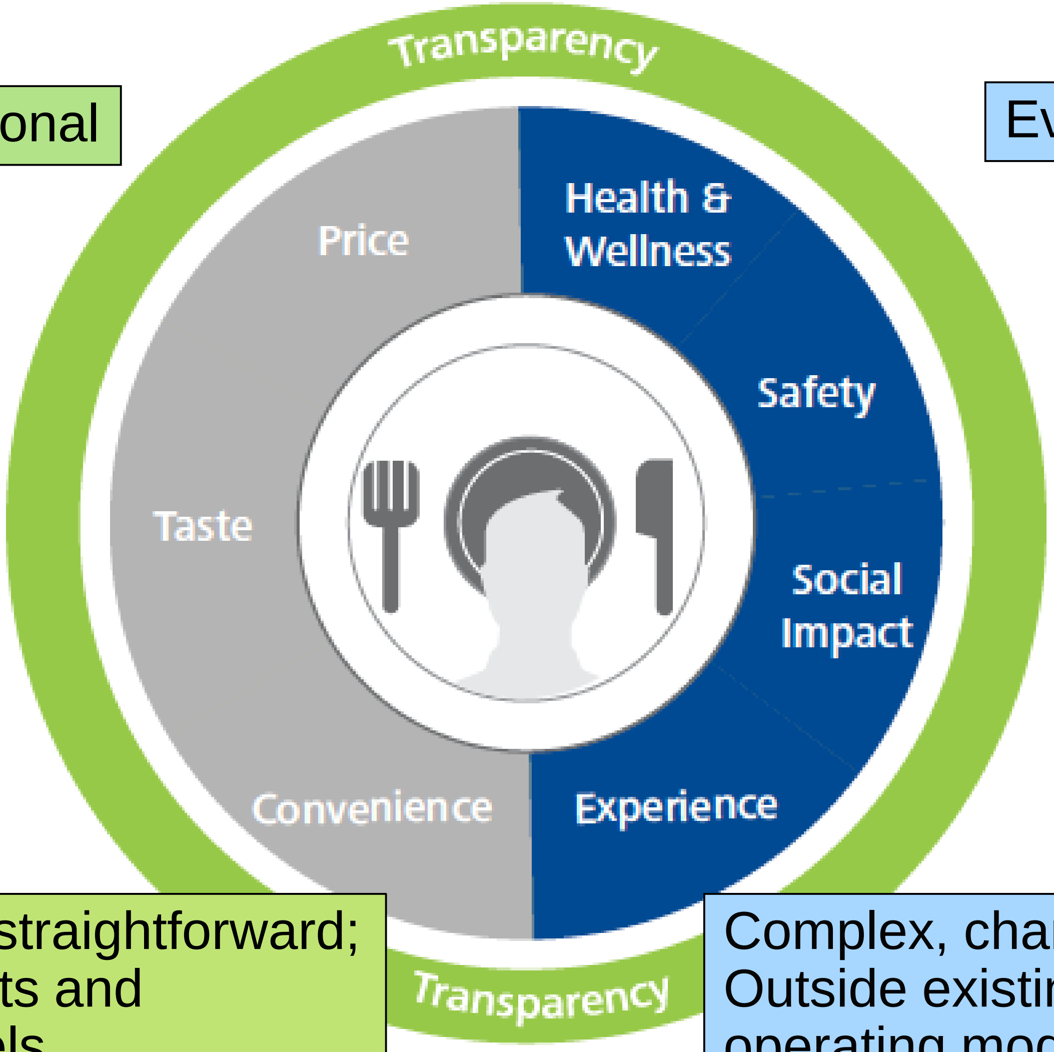
Consumer Value Drivers

Traditional

Evolving

49%

51%



Comparatively straightforward;
Existing skill sets and
operating models

Complex, changing, amorphous;
Outside existing skill sets and
operating models

Source: Deloitte Food Value Equation Survey 2015, Deloitte Analysis

Food Transparency

- production practices

- organic, natural, GMO
- antibiotics, additives
- animal welfare
- employee welfare

- processing practices

- clean labels
- water + energy usage

- food safety

- provenance

- who and where

Health and Wellness

- food's impact on health

- more than calories
- ties to aging population
- nutrition
- disease prevention
- symptom relief
- longevity
- cognitive well-being

- food safety

- free from harmful
- clearly labeled
- minimally processed
- simplicity

Food Industry Context

- ✓ 2016 was a very tough year for grocers
- ✓ The supermarket industry is a 1.5% business
- ✓ Most retailers perceive themselves as buying agents for consumers, but the definition is changing
- ✓ Food retailing is polarizing: Discounters and Differentiators
- ✓ Shifting balance of power toward consumers
- ✓ Intensifying retail competition, too much square footage
- ✓ Online shopping rising rapidly from a small base
- ✓ Supply chain visibility and traceability is improving
- ✓ Food safety concerns dominate
- ✓ Large food manufacturers losing share but reacting

FMCG DEPARTMENT PERFORMANCE

	$ Vol (Billions)	$ % Growth	Unit Vol (Billions)	Unit % Growth
CENTER STORE EDIBLES	**372.8**	**-0.9**	**154.2**	**-1.5**
GROCERY	251.9	0.0	112.9	-1.2
DAIRY	68.2	-4.4	26.3	-2.7
FROZEN FOODS	52.7	-0.3	15.1	-1.8
FRESH PERISHABLES*	**146.5**	**0.6**	**58.6**	**1.3**
MEAT*	54.1	-1.2	16.5	1.6
PRODUCE*	48.9	1.7	32.2	1.1
BAKERY*	11.6	1.3	4.0	1.6
DELI*	25.1	2.0	4.9	2.0
SEAFOOD*	6.9	1.0	1.0	-2.2
HOME & PERSONAL CARE (HPC)	**161.2**	**0.7**	**31.9**	**-1.0**
HEALTH CARE	43.8	2.6	6.6	0.6
BEAUTY CARE	16.4	-1.3	3.1	-3.1
PERSONAL CARE	42.9	-0.1	8.7	-0.8
HOUSEHOLD CARE	58.1	0.5	13.6	-1.4
NON GROCERY	**138.2**	**0.4**	**26.0**	**-0.8**
GENERAL MERCHANDISE	44.7	-1.5	7.2	-1.8
PET CARE	20.4	1.2	5.6	-1.5
TOBACCO + ALTERNATIVES	73.2	1.4	13.2	0.1

Source: Nielsen Answers and Nielsen FreshFacts, Total U.S., 52 weeks ended July 1 2017 vs. year-ago, UPC-coded + Random-weight (*) See Endnotes

Discount formats account for approximately 42% of retail food sales…and the proportion is growing

Price transparency is not far off….

- Fastest growing grocer in the U.S.
- $3 Billion five-year plan to open 650 stores - 2000 by 2018-19
- Success in upper-middle class locations
- National marketing effort
- The Great Britain experience bears watching

- Spring 2017 debut – 25 stores in Virginia and the Carolinas
- More upscale, larger stores, more national brands than Aldi
- Underperforming – slowed rollout, format modifications

How High?

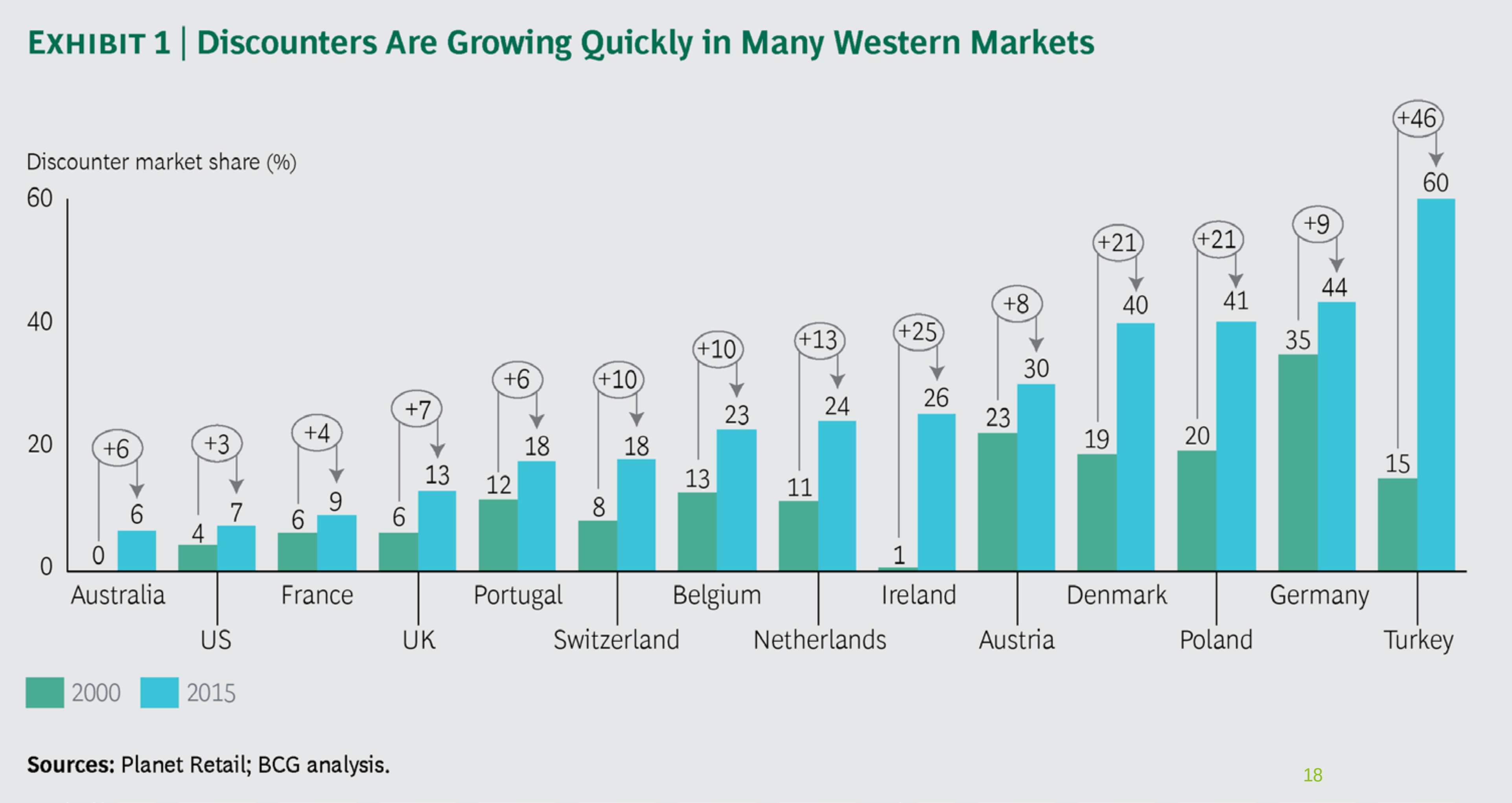


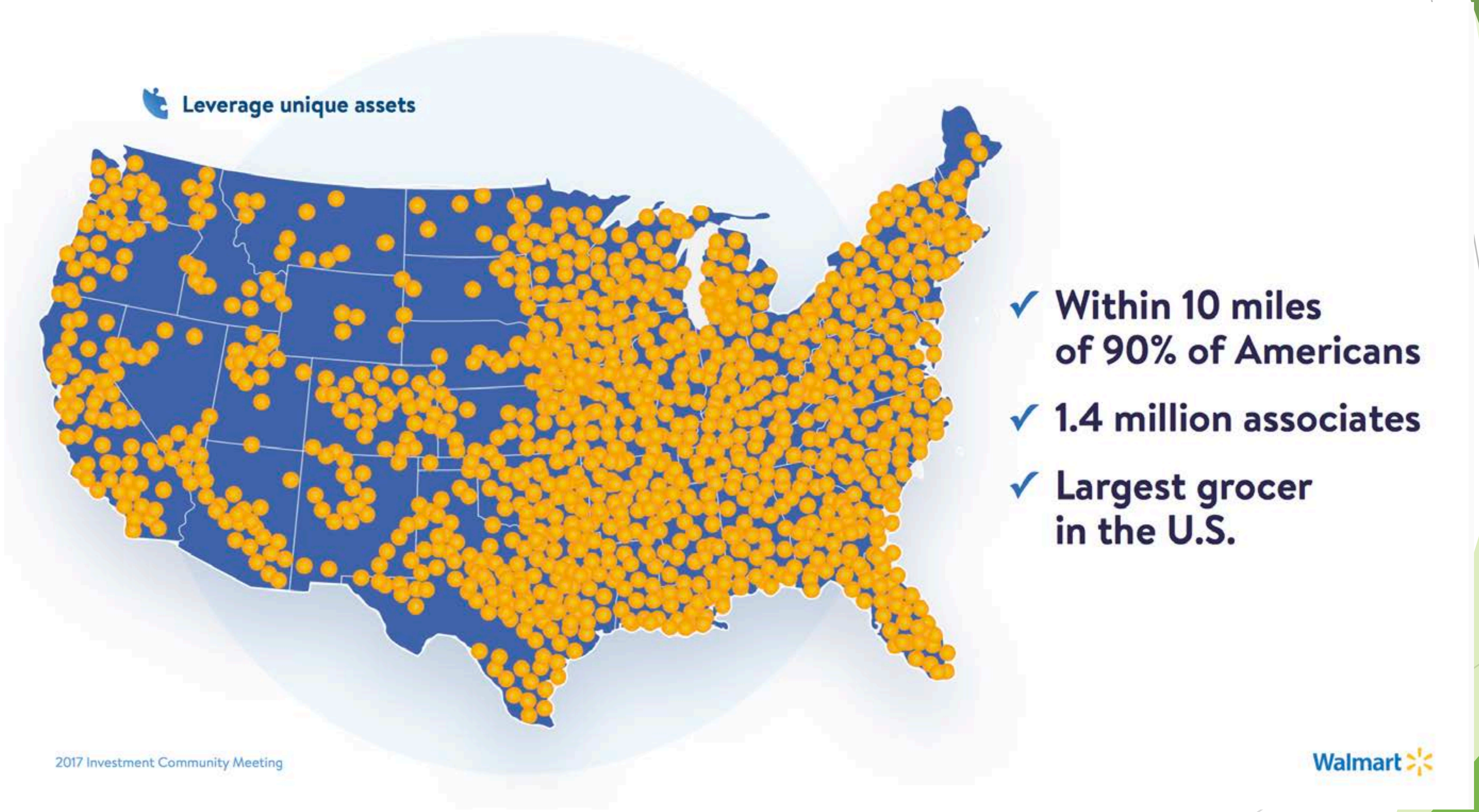
EXHIBIT 1 | Discounters Are Growing Quickly in Many Western Markets
Discounter market share (%)
60
40
20
0
Australia 0 6 +6
US 4 7 +3
France 6 9 +4
UK 6 13 +7
Portugal 12 18 +6
Switzerland 8 18 +10
Belgium 13 23 +10
Netherlands 11 24 +13
Ireland 1 26 +25
Austria 23 30 +8
Denmark 19 40 +21
Poland 20 41 +21
Germany 35 44 +9
Turkey 15 60 +46
2000
2015
Sources: Planet Retail; BCG analysis.

Dollar General

Resurgence of Walmart

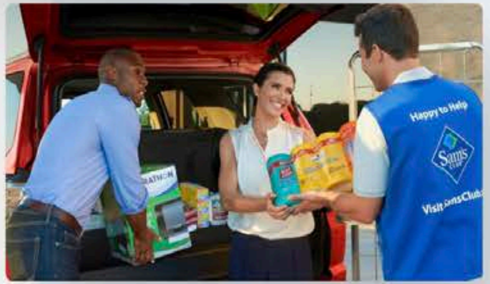
- Investing in Margin
- Improved execution
- Curtailing new store growth
- Large investments in tech and eCom

Future Omnichannel strategy?

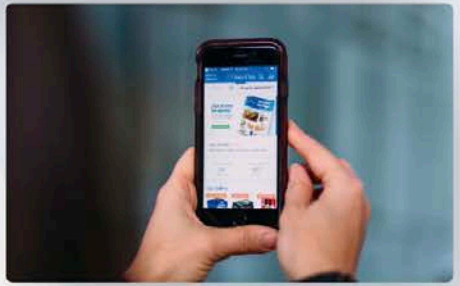


Seamless grocery customer experience

Shop in a store



Pick it up



Have it delivered

To the home, in the garage, or all the way to the fridge

5,316 stores and clubs, within 10 miles of 90% of the population, supported by 147 distribution centers.

2017 Investment Community Meeting

Next day delivery possible for 87% of country

Walmart

amazon

What business?
What Industry?
What market share?
What profit?

AMAZON ACQUIRES WHOLE FOODS

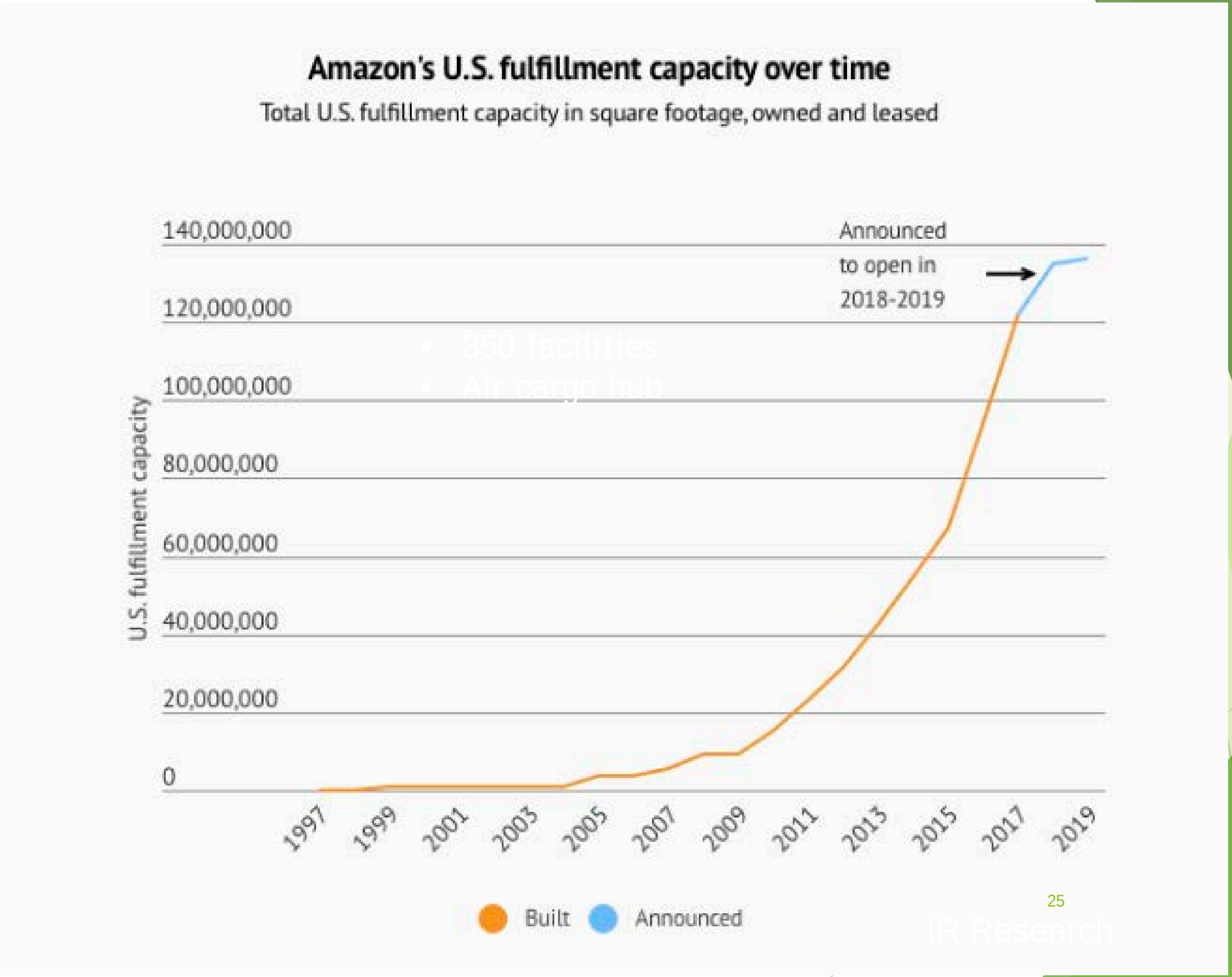
Grocers react as Amazon enters the market

Stock prices for other publicly-traded chains crashed after Amazon announced plans to buy organic grocer Whole Foods.

GROCER	STOCK PRICE CHANGE, THURSDAY TO FRIDAY	MARKET CAPITALIZATION	U.S. STORES
Whole Foods	27% ↑	$13 B	465
Amazon	3.1% ↑	$476 B	-
Ahold* (Giant)	-5.4% ↓	$26 B	2,260
Walmart and Sam's Club	-6.5% ↓	$225 B	4,692
Costco	-6.9% ↓	$74 B	510
Target	-8.4% ↓	$28 B	1,807
Sprouts Farmers Market	-12.9% ↓	$3 B	272
Kroger* (Harris Teeter)	-14.6% ↓	$20 B	2,792

*Dutch company Ahold Delhaize owns U.S. grocery chains including Food Lion and delivery service Peapod. Kroger owns chains Dillons and King Soopers. Costco locations are in the U.S. and Puerto Rico.
Note: Jeffrey P. Bezos, the founder and CEO of Amazon.com, owns The Washington Post.

Sources: Bloomberg News, the companies
DARLA CAMERON AND KEVIN SCHAUL/THE WASHINGTON POST



- 350 facilities
- Air cargo hub

IR Research

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GROCERY WARS

Amazon Will Reportedly Merge AmazonFresh With Prime Now to Streamline Grocery Delivery

By **Clint Rainey**

HOME › NEWS & FEATURES

Here's How Acquiring Shipt Will Bring Same-Day Delivery to About Half of Target Stores in Early 2018

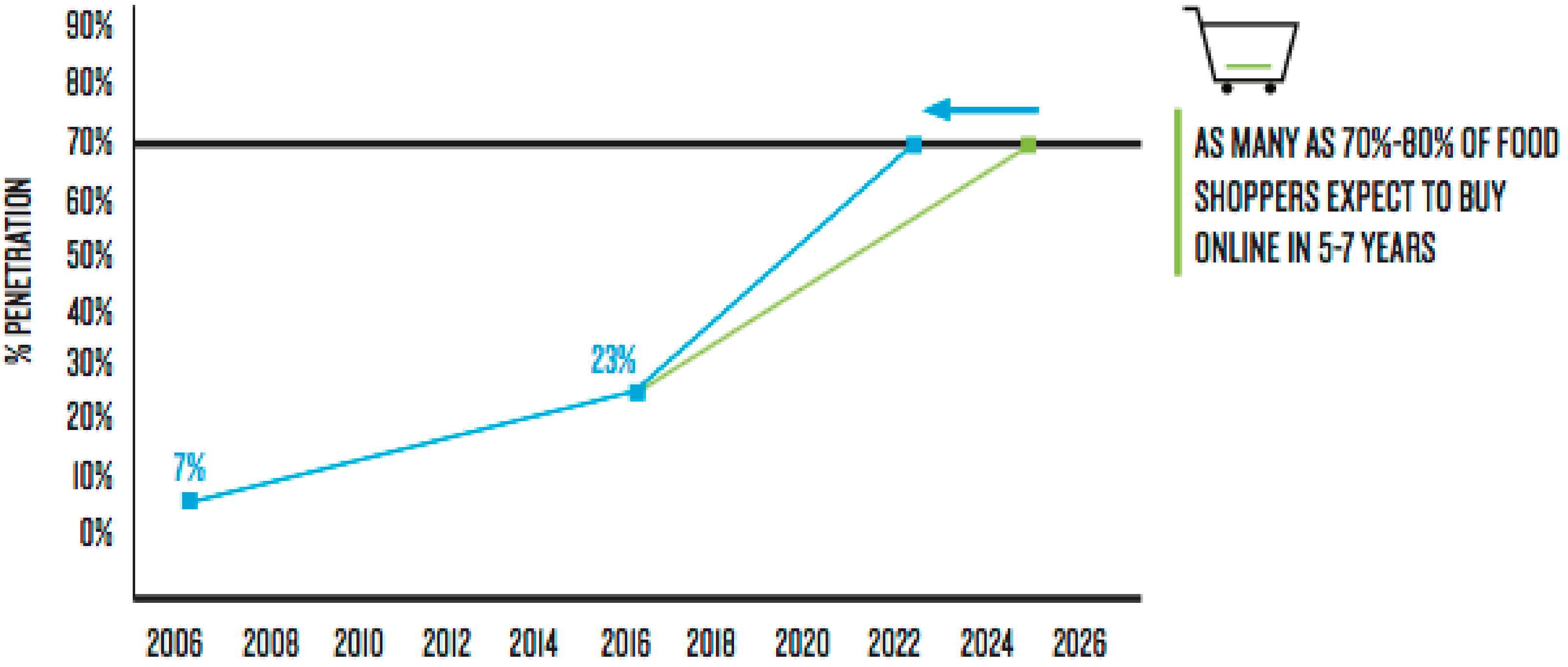
Restock Kroger Plan

2018-2020	Incremental Operating Margin Growth	Incremental Operating Margin Investment	Shareholder Value
Redefine Customer Experience • Digital • Store Optimization • Smart Pricing • Our Brands	$2,300M	$3,100M	
Partner for Customer Value • Infrastructure & Technology Upgrades • COGS • Alternative Revenue Streams	$1,775M	$400M	
Develop Talent	$ 375M	$500M	
Live Our Purpose		$50M	
	$4,450M	**$4,050M**	**= $400M**

ONLINE – How Much? How Fast?

GROCERY COULD STATURATE WITHIN 5-7 YEARS

DIGITAL FOOD RETAILING IS EXPECTED TO MATURE MORE QUICKLY THAN PREVIOUS FORECASTS



Source: Nielsen Digital Segmentation Survey, 2016; "CPG Ecommerce in the U.S.," eMarketer, Oct. 2016.

ONLINE – How Much? How Fast?

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ONLINE SALES		CAGR (2016-2025)	PERCENT OF TOTAL RETAIL*	GROCERY STORE EQ**
2016 CURRENT	$20.5B	-	4.29%	764 STORES
2025 CONSERVATIVE	$44.6B	9.00%	8.51%	1,659 STORES
2025 MODERATE	$72.6B	15.07%	13.86%	2,702 STORES
2025 AGGRESSIVE	$103.3B	19.67%	19.72%	3,844 STORES

* Total F&B Retail sales (excluding non-consumer) are estimated to reach $523.8B by 2025.

** Calculated on the median weekly sales per supermarket-2014, according to The Food Retailing Industry Speaks 2014, Food Marketing Institute ($516,727)

Nielsen: 2017

Food Industry Disruption

CONVENIENCE PRESSURE $$$
HEALTH VALUE EQUATION

MARGIN PRESSURE $$$

SUPPLY SIDE START-UP CHALLENGERS

PRESSURE FOR PERSONALIZATION

NGA Nielsen Report Methodology

Engaged *3,008* U.S. adults, 18 years of age and older

Representing *regional versus just national* Independent Grocer shopper groups

Shoppers who self-identified as spending *50% or more of their grocery shopping* at an Independent grocery store

The survey was conducted between *November 13 – December 8, 2017*

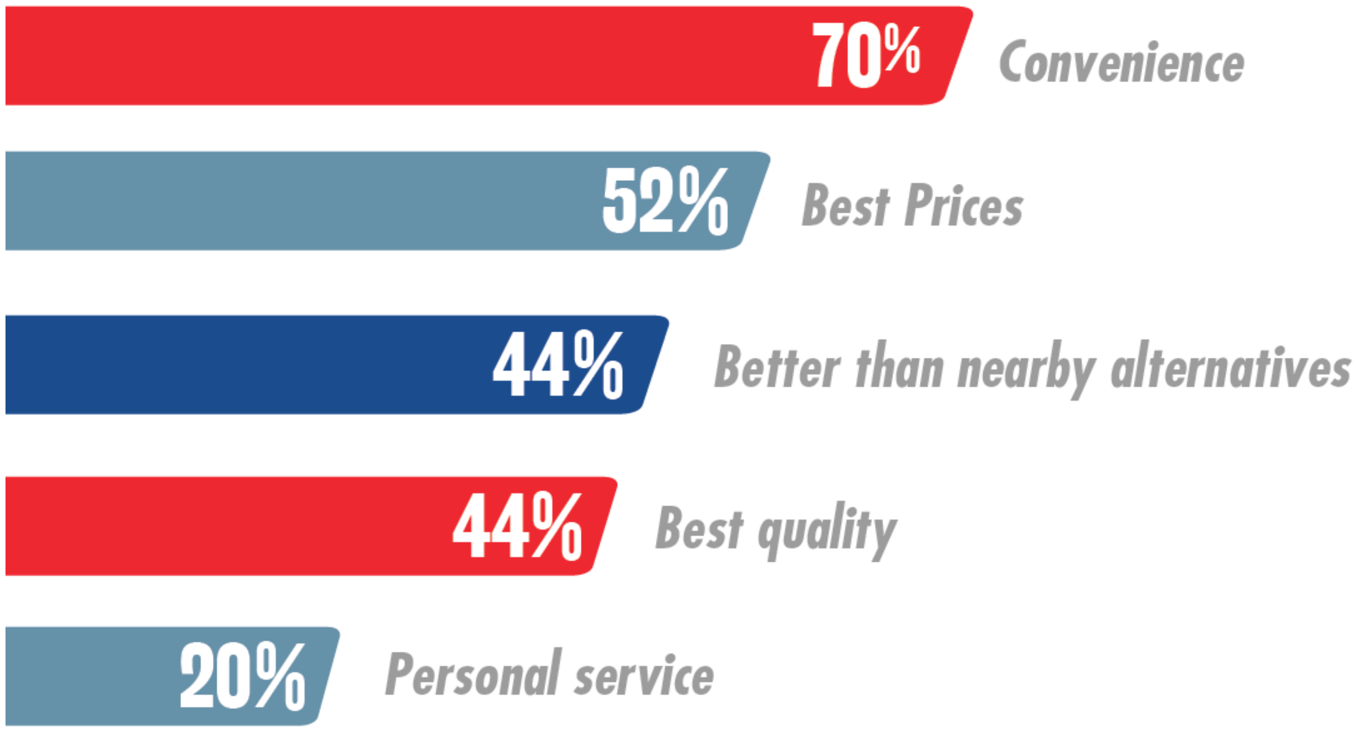
Convenience and Price are Top Drivers

of reasons to shop at Independent

Spend at least 50% more at an **Independent store**

14% ***Switched to local supermarkets in the past 12 months***

REASONS TO SHOP INDEPENDENTS



Drivers of Satisfaction

Primary Attribute Drivers

- Features low prices
- Store resolves shopping /product/service issues immediately
- Sells high quality meats
- Sells high quality fruits & vegetables

Secondary Attribute Drivers

- Has courteous, friendly employees
- Has a store layout that makes it easy for me to shop
- Pays attention to customers' special requests or needs
- Is active in and supports our local community
- Is a clean, neat store

Independent Grocery Shopper

Higher **satisfaction… leads to these critical shopping behaviors:**

- **Continue to shop at the store** instead of shopping online
- **Speak positively** about the local supermarket
- **Recommend** the store to others through **word of mouth**
- **Support the local supermarket because it is linked to the community** through employees, local programs, and community donations
- **Recommend** the store to others through **social media**

HEALTH & WELLNESS

63% *The majority of Independent shoppers expect their grocery stores to support them with a* ***healthier lifestyle.***

The top recommendations included:

28%	Instructions on how to cook with certain foods
25%	Help with understanding label information including ingredient lists and nutritional claims
23%	General guidance on food that gives good nutritional value for the dollar

NGA
NATIONAL GROCERS ASSOCIATION

FMS
Helping retailers succeed.

NGA
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Food Insecurity Nutrition Incentive Program (FINI)

- Doubles benefits for SNAP customers for purchase of fruits and vegetables
- 1-1 Matching funds
- Partner with a non-profit or government agency
- Prioritizes projects located in food deserts and underserved community
- $25 million available this year, but funding expires
- 2018 Farm Bill
  - House Bill – Triples Funding
  - Senate Bill – Doubles funding

Healthy Food Financing Initiative (HFFI)

- **<u>Goal:</u>** to improve access to healthy food in low-income communities
- Provides one-time grants and loans to projects like grocery stores, farmers markets, food hubs, etc. in urban and rural food deserts
- Public-private partnership model leveraging loans, federal tax incentives, and funding from financial, healthcare and philanthropic institutions
- Funding comes through Treasury (CDFI fund), HHS, and USDA.
- 2014 Farm Bill authorized $125 million in funding, but only $1 million allocated over last 2 years

SNAP Program Changes

- Programmatic Issues
  - More reporting requirements
  - Frequent outages
- 2018 Farm Bill
  - Ban on processing fees
  - No harmful mandates or participation fees
  - No Harvest Box
  - Significant investments in healthy incentive programs
    - FINI
    - Retail Based incentives
    - Fluid milk incentives
  - System modernization
    - Mobile technologies
    - National gateway
    - Online purchasing pilot program

Questions?

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